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Citi Cards

BY HAND

January 26, 2009

The Honorable Robert Menendez
United States Senate
Washington, DC 20510–3005

Dear Senator Menendez:

I am writing in response to your December 19, 2008 letter to Vikram Pandit. In your letter you requested information regarding our plans for implementing the new Federal Reserve Board regulations prohibiting credit card lenders from applying increased interest rates to new or outstanding balances, except under extremely limited circumstances. These regulations, once implemented, will nearly eliminate the ability of lenders to reprice existing balances for credit, funding, or market risk. While compliance with the new rules is not mandatory until July 2010, given their scope, we have already initiated the process of developing a new business model that brings stability to our business, while maintaining the availability of credit for consumers.

In your letter you note that "the health of the economy depends on the financial health of consumers -- we cannot disconnect the nation's GDP from its credit card holders' APR." We agree that credit cards provide a critical role in facilitating the ability of consumers and businesses to efficiently and securely make purchases and payments and borrow money. In the U.S., there was $1.9 trillion in sales transacted on credit cards in 2007, and there is currently $4.8 trillion credit available to consumers and businesses. Based on available national economic figures, we estimate that 20% of total personal consumption expenditures flow through credit card transactions. An important step in connecting the consumer to the nation's GDP is the need to ensure the continuation of lending by banks.

Current Market Conditions

Before responding directly to the concerns voiced in your letter, I believe it is important to recognize that the credit card industry is facing enormous challenges that threaten the viability of a product that tens of millions of American consumers use everyday, many times a day. In a normal operating environment, when funding rates and loss rates remain stable and predictable, the business can expect to generate an annual return of approximately 2-2.5% (or $2.00 to $2.50 for every $100 we lend annually). Since mid-2007 the industry has witnessed significant disruption to the funding and credit markets, which has not only severely impacted returns, it has dramatically affected all institutions' ability to secure funding in order to continue lending to consumers through the credit card. The adverse conditions within the credit markets were a key contributor as Citi's North American credit card operations reported losses of more than $1.2 billion in the second half of 2008. Furthermore, as the broader economic environment deteriorated, our loan losses jumped from 5.10% to 8.04% between the fourth quarters of 2007 and 2008. This represents more than $3.5 billion in incremental loan losses in 2008 alone. The factors that triggered these losses continue to negatively impact the business as the recessionary environment worsens. It is against this backdrop that Citi continues lending and servicing our customers while managing to the new regulatory changes requiring a sustainable business model that meets the needs of Citi's customers and investors.

Preparing for the New Regulations on Credit Card Lending
In the U.S., approximately $1 trillion of credit card loans have been booked by financial institutions and funded through investors based on the fundamental premise that the holders of these accounts would be able to manage systemic risk (changes to credit, funding, and market conditions) through the effective use of repricing. This form of repricing has allowed lenders over the last decade to provide credit to consumers at very competitive rates, but always with the condition that should systemic risk increase, repricing of existing loans was available as a way to manage that risk, thus ensuring the ongoing availability of credit to consumers and businesses. With the new rules, the ability to manage systemic risk through repricings will be eliminated. It is our view that in order to maintain the health of the system and to ensure the long-term availability of credit for consumers and businesses in an environment where repricing is no longer available, loans would need to be priced higher at the outset. We believe institutions may also be required to further diminish available credit by closing accounts and lowering lines, which would in turn delay an economic recovery, prolong the credit crunch and further dampen consumer spending.

Moreover, based on our experience with bank operating systems implementation and integration, and given the scope of the required changes, it would be impractical to implement the new rules immediately without posing significant risks to the systems, not the least of which might be serious inconvenience for our cardmembers. Even with the established transition period, we believe that credit card lenders will be hard pressed to develop an entirely new business model and then appropriately design, test and implement the systems changes required to support the new model. Recognizing these facts, the regulators saw fit to provide "institutions and the markets for credit card securities with 18 months in which to adjust interest rates and other account terms to compensate for the restrictions in the final rules." The transition period is an essential step in the regulatory process and will help to avoid further disruptions to the markets impacting institutions and consumers as well as protect the safety and soundness of the payments network.

Repricing is only one of the ways that we intend to prepare for the new regulations. A radical transformation of the industry business model will be required to sustain industry health under the new regulations and make unsecured card loans a viable and continuing source of credit for millions of customers. Development of the new model will involve rethinking marketing strategies, underwriting approaches, and financial models, as well as changing customer communications, technology, customer service, payment processing, and statement rendition. It will have an immediate deleterious impact on our funding sources as investors will need time to build trust that the business model will provide a reasonable return. None of these changes can be made hastily if the industry is to act prudently and responsibly.

Your letter suggested that we take steps to reduce rates and develop programs to assist cardmembers struggling with their payments similar to the way you are encouraging mortgage lenders to reduce interest rates and develop payment schedules that prevent foreclosures. We agree and we have and will continue to work with our cardmembers facing hardship. For example, Citi has substantially increased efforts to reach out to cardmembers facing financial difficulty and we have created a number of programs designed to assist them in repaying their existing loans. We are rolling out new programs with broadened eligibility criteria for customers who, although current on their accounts, could use some additional help to repay their balances. We are also developing payment programs that accelerate loan amortization without materially increasing the cost to the consumer. We expect these programs to impact millions of credit card accounts of our non-delinquent customers. Already, we have seen substantial increases in new entrants into these programs.

Despite the many challenges facing our business, we are committed to ensuring the long-term availability of credit in the marketplace through the expansion of credit to new and existing cardmembers, with incremental credit lines to existing customers, targeted new-account acquisitions, expanded eligibility for balance-consolidation offers, and incentives encouraging higher card utilization and spend, subject to Citi’s customary sound lending standards. In 2009, Citi’s credit card operation hopes to acquire millions of new accounts, generating tens of billions of dollars of new credit lines to U.S. consumers and businesses.

Perhaps more so than other businesses, Citi’s credit card division clearly understands the connection between the financial health of consumers and that of the broader economy. And we share your concerns for consumers knowing that many are facing difficult times. Please know that we are working hard to assist them and to balance the concerns of all stakeholders as we manage through this difficult economic period.

I hope this letter is responsive to your concerns.

Sincerely,

John P. Carey